

Introduction

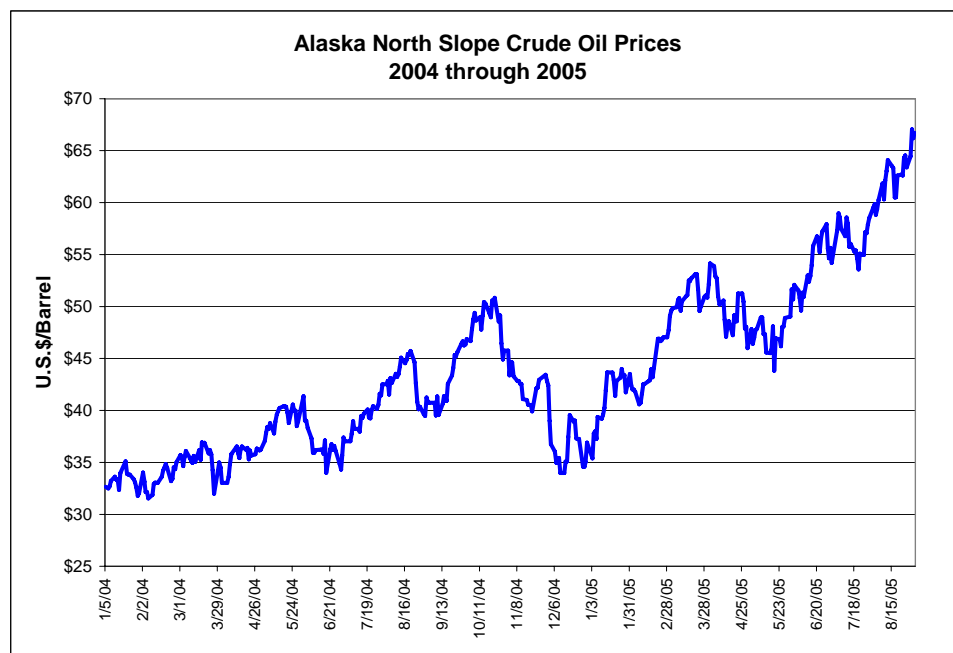
- Governor Arnold Schwarzenegger has directed the California Energy Commission to prepare a brief petroleum market summary focusing on causes and impacts of recent unprecedented crude oil and gasoline price increases. This summary will discuss petroleum prices, production levels and inventories in California and the U.S., in particular highlighting the effects of Hurricane Katrina on the Gulf Coast and its influence on California fuel prices and supplies.

Crude Oil Prices and Inventories

- Commercial stockpiles of crude oil in the U.S. have been fluctuating around 320 million barrels for the last two months, and as of August 26 totaled 321.4 million barrels. Although down from a peak of almost 334 million barrels in May, current stocks are over 40 million barrels above the average of the previous five years.
- After a brief decline during mid-July, world crude oil prices have continued to climb, repeatedly setting new record highs. Prices for Alaska North Slope crude oil, an important refinery input for making gasoline and diesel on the West Coast, have increased about \$23 since May 19, peaking at \$67.06 per barrel on August 30 before falling back slightly to \$66.72 by September 1.
- This latest price spike has been driven by disruptions to Gulf Coast oil production and refining facilities from Hurricane Katrina, lost oil production in Ecuador due to civil unrest, continuing violence in Iraq and strikes in Nigeria, strained relations between the U.S. and Venezuela, tensions with Iran over the resumption of its nuclear program, and reports that demand growth may be picking up again after slowing during the first half of 2005. Loss of almost 95 percent of Gulf Coast oil production to Hurricane Katrina, about 1.4 million barrels per day, has moved the Bush administration to begin releasing Strategic Petroleum Reserve crude oil supplies into affected markets.¹ This lost production will gradually return to more normal levels, but its effects will linger for months.
- On September 2, the International Energy Agency announced that its 26 member countries will make available 2 million barrels per day of petroleum from strategic reserves, including crude oil and gasoline, in response to the impacts of Hurricane Katrina. These volumes will be provided for a period of 30 days. In 2

weeks the IEA's Governing Board will meet to assess conditions and review their actions.

- Although California produces about 42 percent of the crude oil used as feedstocks to the state's refineries, the price of crude oil here moves in tandem with prices on world oil markets. The same is true of gasoline and diesel prices. When a shortage develops in one area and prices rise, traders in other regions have the option to transport fuels to the affected area if the costs and risks of doing so are warranted. In this way, after adjusting for transportation costs and differences in crude oil or fuel qualities, prices tend to balance out between regions over time.



In 2005, the cost of crude oil has comprised between 42 and 56 percent of the retail price of a gallon of California regular-grade gasoline.

Wholesale Gasoline and Diesel Prices

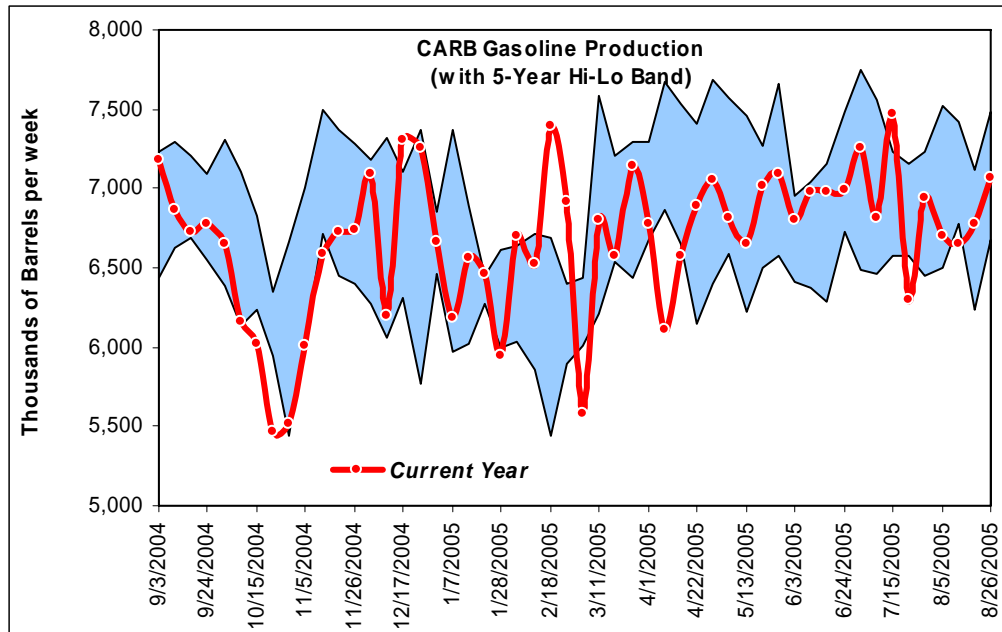
- Although a spate of refinery outages in mid-August had lifted spot wholesale gasoline prices above \$2 per gallon for the first time throughout much of the country, the loss of Gulf Coast refining and oil production capacity to Hurricane Katrina has caused almost unparalleled price spikes. U.S. gasoline inventories had already fallen to 194.4 million barrels as of August 26, about 12 million barrels below last year and almost 4 million barrels below the average of the last 5 years.

- As the impacts of the hurricane became clear, spot wholesale prices spiked sharply. According to the U.S. Energy Information Administration (EIA), as of August 30 Los Angeles spot wholesale gasoline prices reached \$2.89 per gallon, although other sources reported substantially lower spot price levels for California. The EIA reported price was an increase of 48 cents from the previous day and 66 cents from August 26. In the Gulf Coast, spot gasoline prices reached \$2.65 on August 30, an increase of 63 cents from the previous day and 76 cents from August 26. Roughly 2 million barrels per day of refining capacity was shut down due to the hurricane. These price impacts will gradually diminish as Gulf Coast refining capacity returns to normal, but could persist for months if some facilities are significantly damaged, or if other problems develop.²
- California and Gulf Coast spot wholesale gasoline prices had fallen to near parity in mid-August with refinery outages in the Eastern U.S. Following similar refinery problems in California, prices in the state increased to 39 cents higher by August 29. The difference between California and the Gulf Coast, however, declined to 24 cents by August 30, as the effects of the hurricane began to be understood.
- Wholesale California diesel price increases have been much less severe than for gasoline, because they were already very high and because national distillate inventory levels are relatively more substantial than gasoline inventories. U.S. distillate stocks were over 135 million barrels as of August 26, almost 9 million barrels above a year ago and about 12 million barrels above the average of the previous 5 years. As of August 30, Los Angeles spot diesel prices were \$2.18 per gallon, up 13 cents from August 26. Both Gulf Coast and New York spot prices had jumped 30 cents over the same period, to levels within one to two cents of Los Angeles prices.

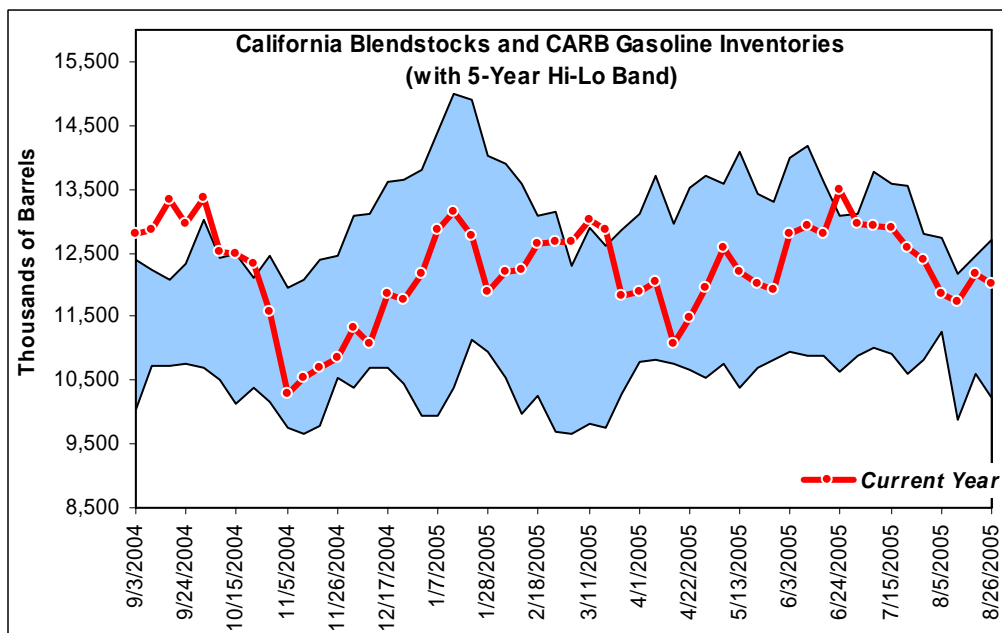
California Refinery Production and Inventories

- Unplanned refinery outages dramatically reduced California reformulated gasoline production during the week ending July 22 to below the range for the last five years. Since then, gasoline production has struggled to build back up to more normal levels. As a result, combined inventories of reformulated gasoline and gasoline blend stocks fell from the relatively high levels of June and early July to near average levels. By August 26, weekly production exceeded 7 million barrels for the first time in 6 weeks and helped rebuild reformulated gasoline and gasoline blendstock inventories back to levels in the upper range for the previous 5 years. However, these stocks are still down more than five percent from last year.⁴

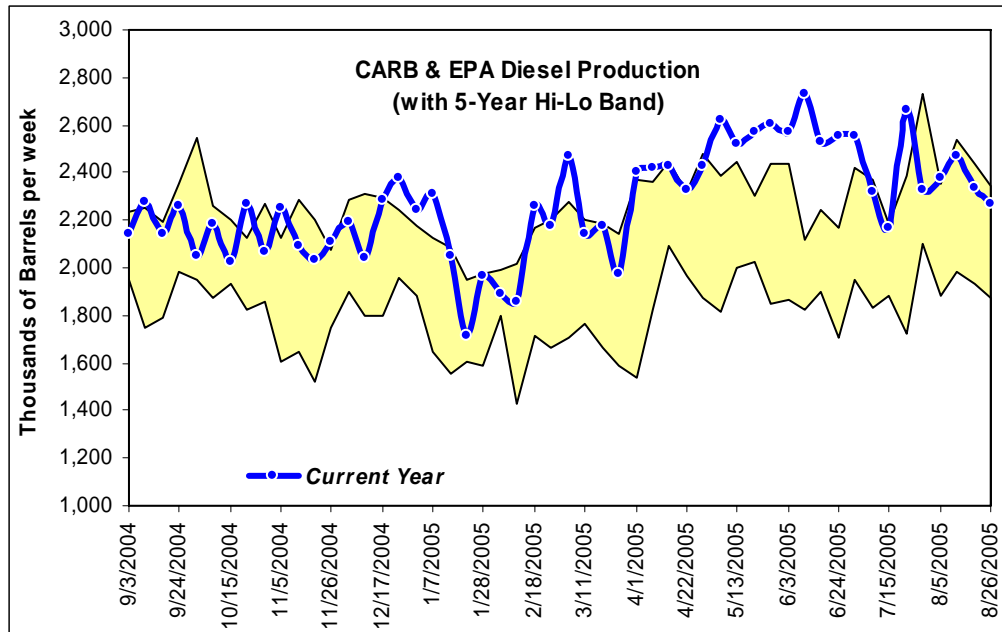
- California low-sulfur diesel production, both California and U.S. Environmental Protection Agency (EPA) diesel combined, has been at the high end of the five-year range for most of this year, although for the week of August 26 it was down three percent from a year ago. However, high demand in California and elsewhere in the country, as well as unplanned refinery outages that affected diesel-producing units in the state, have kept steady pressure on low-sulfur diesel inventories. Throughout August, these diesel stocks have been at the low end of the five-year range. As of August 26, state low-sulfur diesel inventories were almost 15 percent lower than a year ago.
- The U.S. Environmental Protection Agency has granted an emergency waiver on enforcement of gasoline Reid vapor pressure (RVP) and diesel sulfur rules due to supply disruptions caused by Hurricane Katrina. This waiver applies to all states. Higher RVP gasoline may be used where lower RVP fuel would normally be required, but conventional gasoline cannot be used in lieu of reformulated gasoline. Red-dyed high-sulfur diesel can be used as a substitute for low-sulfur diesel fuel. However, the waiver is only for 2 weeks, not long enough to significantly help the California market, unless it is extended to carry over into the transition to winter-grade gasoline specifications starting November 1.
- President Bush has temporarily waived the Jones Act rules which limit marine traffic between U.S. ports to U.S. flagged ships, due to disruptions in pipeline and maritime transportation of fuels from Hurricane Katrina. Currently, volumes of fuels normally transported throughout the Eastern U.S. from Gulf Coast refineries by major pipelines are well below capacity, although throughput is increasing steadily. At this time, it is not yet clear what the limits and conditions are on exercising this waiver.
- The Energy Policy Act of 2005 was passed by Congress and signed by the President in late July. Among provisions of the Act affecting the California oil industry are an increased renewable fuels requirement, elimination of the oxygenate requirement, incentives for oil and gas production, various programs to streamline oil and gas lease permitting, and approval of an offshore oil and gas resource inventory. This resource inventory does not allow exploratory drilling, but will permit seismic surveys. Other measures include authorization to fill the Strategic Petroleum Reserve up to one billion barrels, coastal impact funding for states with significant offshore oil and gas drilling (California is not eligible due to current offshore oil leasing moratoria), and marginal well royalty relief that would only come into effect with oil and gas prices less than one-fourth of today's prices.



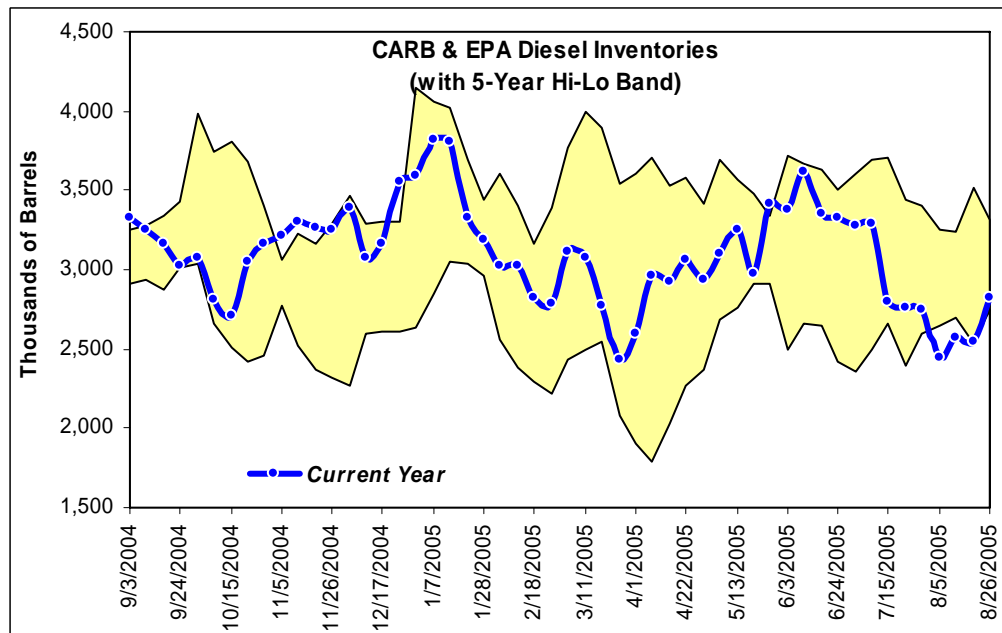
California gasoline production dropped sharply in late July due to unplanned refinery outages.



By historical standards, California gasoline inventories have been relatively normal in recent months.



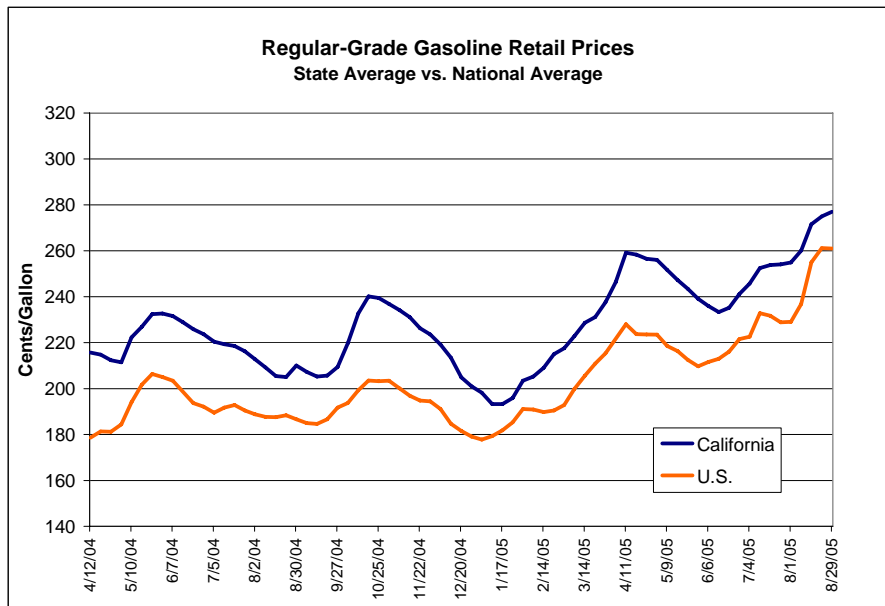
In 2005, California low sulfur diesel production has overall been relatively high.



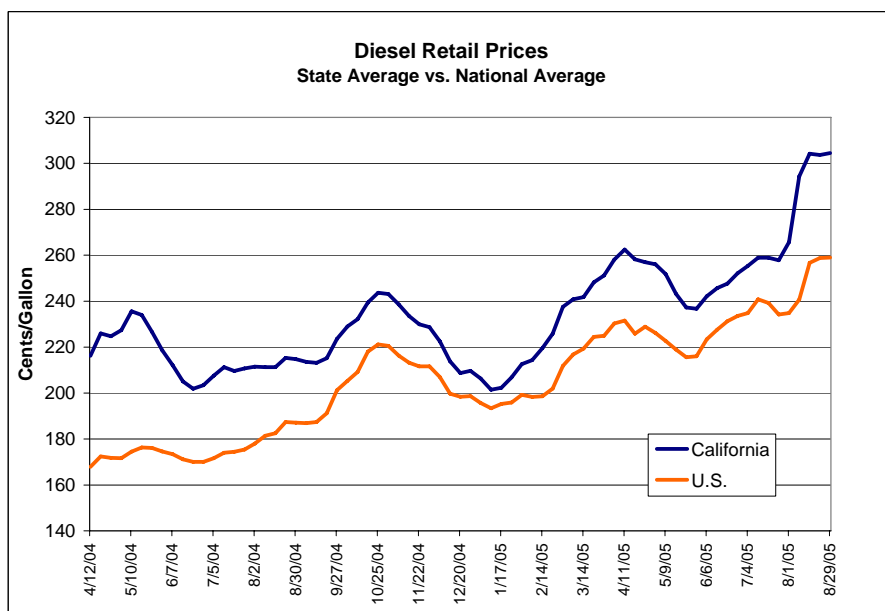
High demand in California and elsewhere has depleted diesel inventories in recent months.

Retail Gasoline and Diesel Prices

- California retail regular-grade gasoline prices had been rising from recent lows of \$2.33 per gallon on June 13 due to crude oil price spikes and unplanned refinery outages in the state and elsewhere in the U.S. As of August 29, the statewide average price for regular gasoline had increased to \$2.77, 67 cents above a year ago and a new record high (when not adjusted for inflation).
- Nationally, retail gasoline prices also reached record levels. The difference between California and U.S. average retail gasoline prices as of August 29 was 16 cents per gallon, about eight cents below the average for the past year. These most recent figures from the U.S. Energy Information Administration do not yet reflect the more significant impacts of Hurricane Katrina. Results of the next retail price survey will be issued on Tuesday, September 6, 2005.
- California retail diesel prices have broken record highs almost every week in August. On August 15, state diesel prices exceeded \$3 per gallon for the first time. As of August 29, prices had climbed to \$3.05, almost 90 cents above a year ago.
- The difference between California and U.S. average retail diesel prices has grown to levels not seen since April. As of August 29, this difference was almost 46 cents per gallon, down eight cents from August 8, but 18 cents above a year ago. However, these retail diesel prices do not reflect the full effects of rapid changes in wholesale prices due to Hurricane Katrina.
- Retail diesel prices continue to remain very high relative to gasoline prices in California and the nation following a month in which several diesel-producing units in California and elsewhere in the U.S. were idled by unplanned outages. Demand for diesel and other distillates remains high worldwide, making imports more expensive, and with sulfur regulations scheduled to become more stringent, suppliers are concerned about the adequacy of distillate inventories for next winter. As of August 29, the price of diesel in California exceeded regular-grade gasoline by almost 28 cents, down from 34 cents on August 8.



California retail gasoline prices typically exceed U.S. prices due to cleaner burning qualities and distance to other refining centers.



Retail diesel prices nationwide have exceeded gasoline prices for most of 2005.

¹ ANS crude oil prices are from the Wall Street Journal. U.S. crude oil inventory and production estimates are from the Energy Information Administration of the U.S. Department of Energy.

² Spot wholesale and retail gasoline and diesel prices are from the Energy Information Administration of the U.S. Department of Energy.

⁴ California refinery production and inventory information are from the Petroleum Industry Information Reporting Act (PIIRA) database maintained by the California Energy Commission.